

## **Questions and Answers about Debt Cancellation by Depository Institutions**

1. Can a state chartered depository institution offer debt cancellation agreements on their loan agreements?

Yes. The DFI believes that a state chartered depository institution can offer debt cancellation agreements on direct loans as an incidental power under IC 28-1-11-3.1 for banks and IC 28-7-1-9 for credit unions.

2. What steps should a state chartered depository institution take if they wish to offer debt cancellation agreements?

If a depository institution offers debt cancellation, then it is expected that the institution will notify the DFI to ensure that any safety and soundness issues have been addressed. The department would look to 12 CFR Part 7 and 37 as issued by the OCC for National banks for guidance on compliance for state chartered depository institutions. These guidelines became effective June 16, 2003. NCUA authorized debt cancellation for federal credit unions under 12 CFR 721.2 in 2001 with further guidelines in May of 2003. OTS authorized debt cancellation in 1995 if the cost was included in the finance charge.

3. Does the Indiana Department of Insurance consider debt cancellation offered by depository institutions on direct loans to be insurance?

It is our understanding that the Indiana Department of Insurance has not taken the position that debt cancellation offered by depository institutions on direct loans is insurance. Some states have taken that position in at least some instances.

4. Would a depository institution who wishes to offer debt cancellation agreements be required to purchase a third party contractual liability policy to cover any losses?

The DFI would evaluate any debt cancellation program that is submitted to the department by a depository institution. However, if the depository institution obtains a contractual liability policy, issued by an Indiana Department of Insurance approved carrier, then safety and soundness concerns are more adequately addressed. The depository institution using a third party administrator for claims processing can further address these types of issues.

5. Can a depository institution include the cost of debt cancellation in the disclosed finance charge on consumer loans?

If, on consumer purpose loans the depository institution includes the debt cancellation in the cost of credit as part of the basic finance charge or as a “prepaid” finance charge that is collected at the closing of the loan (deducted from the amount financed and reflected in the total disclosed finance charge and Annual Percentage Rate (APR), then the institution would just have to meet safety and soundness concerns and ensure that the total finance charge does not exceed statutory maximums under IC 24-4.5-3-508.

6. What if the depository institution wants to **exclude** the debt cancellation charge from the disclosed finance charge and assess it as an “additional charge” under IC 24-4.5-3-202(1)(e)?

If a depository institution offers debt cancellation on consumer purpose loans other than first lien mortgages and they want to exclude the cost of this coverage from the finance charge, then it must be approved as an additional charge under the above referenced provisions of the IUCCC. First lien mortgage (purchase money or refinance) are covered only by contractual and disclosure requirements under IC 24-4.5-3-105 and 3-301.

7. What does IC 24-4.5-3-202(1)(e) require for a charge to be a permitted exclusion from the finance charge?

The creditor/third party administrator must submit a written explanation of the charge to the department indicating how the charge would be assessed and the value or benefit to the debtor. The department may require supporting documents. The 7 Member Board of the department shall determine whether the charge would be of benefit to the debtor and is reasonable in relation to the benefits. This information would be submitted in addition to any safety and soundness concerns.

Items to be included in any application for approval include: (a) experience and competence of the third party administrator including any other financial institutions that the administrator works with, (b) details on any risks not covered by the contractual liability policy, (c) how the charges for debt cancellation compares to existing credit insurance products, (d) outline marketing practices to be used since these transactions are not subject to licensing requirements under the Indiana Department of Insurance

Please contact the department for additional guidance concerning the above.



